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## In our opinion... , vol. 21 no. 4, Fall 2005

American Institute of Certified Public Accountants. Audit and Attest Standards Team

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# In Our Opinion...

The Newsletter of the AICPA Audit and Attest Standards Team

Vol. 21 No. 4

Fall 2005

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## ASB Approves Final Risk Assessment SASs

by Hiram Hasty

At its October 2005 meeting, the Auditing Standards Board (ASB) approved the final issuance of the risk assessment statements on auditing standards (SASs), subject to the resolution of an issue concerning the evaluation of uncorrected prior-period misstatements (the “iron curtain/rollover” issue). The Securities and Exchange Commission (SEC) is conducting a project that addresses this issue, and new SEC rules prescribing the accounting and measurement of uncorrected prior-period misstatements are expected soon. The ASB expects to resolve this issue within the next few weeks and, if necessary, make revisions to the relevant guidance.

The group of risk assessment standards comprises the following new SASs.

- *Amendment to “Due Professional Care in the Performance of Work,” of Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures,*
- *Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards,*
- *Audit Evidence, which will supersede SAS No. 31, Evidential Matter,*

- *Audit Risk and Materiality in Conducting an Audit*, which will supersede SAS No. 47, *Audit Risk and Materiality in Conducting an Audit*,
- *Planning and Supervision*, which will supersede “Appointment of the Independent Auditor” of SAS No. 1, *Codification of Auditing Standards and Procedures* and SAS No. 22, *Planning and Supervision*,
- *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,
- *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, which will supersede SAS No. 45, *Substantive Tests Prior to the Balance-Sheet*,
- *Assessing Risks* along with *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, will supersede SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit*, as amended, and
- *Amendment to Statement on Auditing Standards No. 39, Audit Sampling*, as amended.

The following are the key changes in audit practice that the SASs are expected to achieve:

- *The quality and depth of the required understanding of the entity and its environment, including its internal control, are significantly enhanced.* The auditor should perform risk assessment procedures in all audits to obtain a sufficient understanding of the entity and its environment, including its internal control. A sufficient understanding is fundamental to an effective audit because it assists and enhances the auditor’s identification and assessment of where material misstatement may occur. In addition, the understanding assists the auditor throughout the audit, for example, in making judgments about materiality and in evaluating audit evidence.
- *Guidance on the assessment of the risk of material misstatement is significantly enhanced and expanded.* Assessing the risks of material misstatement encompasses a combined assessment of inherent and control risk. The concept of assessing risk “at the maximum” without support is eliminated. Auditors should support risk assessments, at whatever level, based on their understanding of the entity and its environment, including its internal control. In addition, as part of the assessment, auditors will identify significant risks that require special audit consideration, and risks for which substantive procedures alone will not reduce audit risk to an appropriate low level.
- *Testing of controls is encouraged.* Testing of controls is encouraged by eliminating the default to maximum risk and the ability to avoid documenting the basis for that conclusion. In addition, the auditor’s understanding of internal control is augmented by specifying that the auditor should evaluate the design of controls, including relevant control procedures over significant risks, and should determine whether the controls have been implemented. Increasing the specificity of guidance about the understanding of internal control in such circumstances is expected to encourage the testing of controls.

Consistent with existing guidance, the auditor is not *required* to perform tests of controls unless (1) the auditor intends to rely on the operating effectiveness of controls to alter the nature, timing, or extent of substantive procedures, or (2) the auditor has determined that evidence obtained from substantive procedures alone will not reduce detection risk to an appropriately low level and audit evidence about the effectiveness of controls must be obtained.

- *The linkage between assessed risks and audit procedures responsive to those risks is improved.* Auditors should determine overall responses to address the risks of material misstatement at the financial statement level, and should design and perform further audit procedures, whose nature, timing, and extent are clearly linked to the assessed risks of material misstatement at the relevant assertion level. The guidance empha-

sizes the importance of the nature of the further audit procedures performed in responding to assessed risks.

- *Guidance on substantive procedures is expanded.* Regardless of the assessed risk of material misstatement, the auditor should design and perform substantive procedures for all assertions related to each material class of transactions, account balance, and disclosure to detect material misstatements at the relevant assertion level. In addition, the auditor should agree the financial statements, including the accompanying notes, to the entity's underlying records, and should examine material journal entries and other adjustments made during the course of preparing the financial statements.
- *Greater emphasis is placed on the testing of disclosures.* Guidance on relevant assertions related to presentation and disclosure has been enhanced to include specific references to the completeness of disclosures and their understandability to users. In addition, throughout the SASs, the use of the phrase "risks of material misstatement in classes of transactions, account balances, or disclosures" reminds auditors to consider how misstatement may occur in disclosures.
- *Guidance on evaluating audit findings is clarified and expanded.* In evaluating audit findings, the SASs specify that auditors should consider the effect of uncorrected misstatements related to prior periods on the current-period financial statements.
- *Documentation requirements are significantly expanded.* The SASs require the auditor to document, among other matters, the results of the risk assessments, both at the financial statement and relevant assertion levels; the nature, timing, and extent of audit procedures performed; the linkage with the assessed risks at the assertion level; and the results of the audit procedures. Documentation is needed to demonstrate that the auditor has complied with the standards and thus drives auditor behavior.

The SASs will be effective for audits of financial statements for periods beginning on or after December 15, 2006. Early adoption is permitted. An audit guide will be issued to assist practitioners in implementing these standards.

## New SAS on Audit Documentation

by Sharon Walker

At its October 2005 meeting, the Auditing Standards Board (ASB) approved for final issuance Statement on Auditing Standards (SAS) No. 103, *Audit Documentation*. The new SAS establishes standards and provides guidance, to auditors of nonissuers, on audit documentation, and supersedes SAS No. 96 of the same name. Audit documentation is an essential element of audit quality and although audit documentation alone does not guarantee audit quality, the process of preparing sufficient and appropriate audit documentation contributes to the quality of an audit.

In developing this SAS, the ASB considered the documentation requirements of the Public Company Accounting Oversight Board's Auditing Standard No. 3, *Audit Documentation*; the International Auditing and Assurance Standards Board's International Standard on Auditing (ISA) 230 (Revised), *Audit Documentation*, issued in September 2005; Government Auditing Standards issued by the Comptroller General of the United States; and suggestions from the National Association of State Boards of Accountancy. Accordingly, the requirements of the SAS are similar, in most respects, to the requirements of Auditing Standard No. 3 and ISA 230 (Revised).

Among other things, the SAS:

- Requires the auditor to prepare audit documentation for each engagement in sufficient detail to provide an experienced auditor, having no previous connection to the audit, with a clear understanding of the work performed (including the nature, timing, extent and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached.
- Provides enhanced guidance on matters that should be documented. For example In addition to the requirements of SAS No. 96 that the auditor document audit finding or issues that in his or her judgment are significant, actions taken to address them (including any additional evidence obtained), and the basis for the final conclusions reached; SAS No. 103 requires the auditor to document discussions of significant findings or issues with management and others, on a timely basis, including when and with whom the discussions took place.
- States that oral explanations on their own do not represent sufficient support for the work the auditor performed or conclusions the auditor reached, but may be used by the auditor to clarify or explain information contained in the audit documentation
- Requires the auditor to document audit evidence that is identified as being contradictory or inconsistent with the final conclusions, and how the auditor addressed the contradiction or inconsistency.
- Requires the auditor to assemble the audit documentation to form the final audit engagement file within 60 days following the report release date. After that date, the SAS requires the auditor not to delete or discard existing audit documentation, and to appropriately document any subsequent additions.
- Specifies a minimum file retention period of five years from the report release date.

SAS No. 103 also amends paragraphs 1 and 5 of AU Section 530, *Dating of the Independent Auditor's Report* by requiring that the auditor's report not be dated earlier than the date on which the auditor obtained sufficient appropriate audit evidence to support the opinion on the financial statements. The SAS is effective for audits of financial statements for periods ending on or after December 15, 2006.

## Practice Alert Addresses Variable Interest Entities

by Michael P. Glynn

The Professional Issues Task Force has issued Practice Alert 2005 -1, *Auditing Procedures With Respect to Variable Interest Entities*, which provides guidance to auditors of nonissuers on planning and performing auditing procedures related to variable interest entities (VIEs). Financial Accounting Standards Board Interpretation No. 46(R), *Consolidation of Variable Interest Entities* (FIN 46R), explains how to identify a VIE and how an enterprise assesses its interest in a VIE to determine whether to consolidate that entity. Generally, an enterprise's consolidated financial statements should include subsidiaries in which the enterprise has a controlling financial interest. That requirement usually has been applied to subsidiaries in which an enterprise has a majority voting interest. FIN 46R addresses situations in which the controlling financial interest is achieved through arrangements other than voting interests.

The Practice Alert provides guidance on:

- Evaluating the completeness of the population of VIEs in which the enterprise may have a *variable interest*. (A variable interest in a VIE is a contractual, ownership, or other economic interest in an entity that changes with the entity's net asset value.)
- Considering the involvement of related parties

- Identifying VIEs of which the enterprise is the *primary beneficiary* (The primary beneficiary is the entity that consolidates a VIE under the provisions of FIN 46.)
- For VIEs of which the enterprise is the primary beneficiary, consideration as to whether the enterprise properly accounted for the VIE in the consolidated financial statements
- For VIEs of which the enterprise is not the primary beneficiary, consideration as to whether the enterprise properly accounted for its interests in accordance with generally accepted accounting principles
- Consideration as to whether additional evidential matter is needed
- Consideration as to whether the enterprise has made the appropriate disclosures about the VIEs with which it is involved, both those of which it is the primary beneficiary and those of which it is not the primary beneficiary
- Obtaining appropriate representations from management
- Consideration as to whether the results of the auditor's procedures with respect to the VIE require any special reporting considerations.

The Practice Alert does not provide guidance on accounting for VIEs. For such accounting guidance, practitioners should refer to FIN 46R and FASB Staff Positions related to FIN 46R. For the latest information and guidance on accounting for VIEs, go to the FASB's Web site at <http://www.fasb.org>.

The Professional Issues Task Force encourages practitioners and AICPA member firms to incorporate the guidance contained in the alert as soon as practicable. The alert is currently available on the AICPA's Web site at: [http://www.aicpa.org/download/auditstd/pract\\_alert/pa\\_2005\\_1.pdf](http://www.aicpa.org/download/auditstd/pract_alert/pa_2005_1.pdf)

## New SAS and SSAE on Use of Terms

by Sharon Walker

The Auditing Standards Board (ASB) has issued Statement on Auditing Standards (SAS) No. 102, *Defining Professional Requirements in Statements on Auditing Standards*, as well as Statement on Standards for Attestation Engagements (SSAE) No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements*. These new standards define the degree of responsibility imposed on the auditor (and the practitioner in attestation engagements) when certain imperatives (such as *must*, *is required*, and *should*) are used in the audit and attest standards. The objective of this guidance is to clarify the audit and attest standards and make them capable of consistent application; thereby, enhancing the quality and uniformity of practice. The new standards are applicable to audit and attestation engagements performed for nonissuers. The term *nonissuer* generally refers to an entity that is not subject to the Sarbanes-Oxley Act or the rules of the Securities Exchange Commission.

Although the degree of responsibility attached to the terms *must*, *is required*, and *should* has not previously been defined, the ASB believes that the terminology, as defined in these Statements, is consistent with existing interpretations of the SASs and SSAEs. The ASB used the same definition of these imperatives as is used by the Public Company Accounting Oversight Board.

The new Statements define the following two categories of professional requirements:



- *Unconditional requirements* – Requirements that the auditor or practitioner must comply with whenever the circumstance, to which the unconditional requirement applies, exists. An unconditional requirement is indicated by the words *must* or *is required*.
- *Presumptively mandatory requirements* – Requirements that the auditor or practitioner must comply with whenever the circumstances, to which the presumptively mandatory requirement applies, exists. However, in rare circumstances, the auditor or practitioner may depart from a presumptively mandatory requirement if he or she documents the justification for the departure and how alternative procedures performed were sufficient to achieve the objectives of the presumptively mandatory requirement. The word *should* indicates a presumptively mandatory requirement.

SAS No. 102 also amends paragraph 5 of AU Section 150, *Generally Accepted Auditing Standards*, by requiring the auditor to document, in the working papers, his or her justification for a departure from the SASs.

The provisions of SAS No. 102 and SSAE No. 13 are effective upon issuance. The amendment to AU Section 150 also is effective upon issuance of SAS No. 102.

The provisions of these Statements apply to existing SASs and SSAEs; they are not intended to apply to interpretive guidance issued by the ASB.

## ARSC Conducts Survey On Independence in Compilation Engagements

by Michael P. Glynn

In January 2005, in an effort to clarify certain matters related to independence, the AICPA's Professional Ethics Executive Committee (PEEC) revised Interpretation 101-3, "Performance of Nonattest Services," in the AICPA's Code of Professional Conduct. The Rule, in part, identifies the circumstances in which a CPA may maintain his or her independence when performing both an attest service and certain nonattest services, such as tax or bookkeeping services, for a client.

One of the requirements in Interpretation 101-3 is that the accountant be satisfied that the client can make informed judgments on the results of the accountant's nonattest services. Many small companies rely on their CPAs to perform bookkeeping services, such as preparing and posting payroll, maintaining the general ledger, and preparing and recording journal entries. Many of these companies do not have access to someone, other than their CPA, who (1) can sufficiently understand the nature of the proposed entries and their effects on the financial statements, and (2) has the knowledge and skill to approve the results of these services. If a CPA performs nonattest services in these circumstances, the independence of the CPA is impaired and he or she would need to disclose that fact in the accountant's compilation report. Such disclosure might cause third-party users to be less comfortable with the financial statements than they would be had the accountant been independent.

Because of the evolving complexity of the independence standards, the Accounting and Review Services Committee (ARSC) is seeking input from CPAs, their clients, and third-party users of compiled financial statements regarding the need for independence in compilation engagements.

Toward that end, the ARSC has issued a survey entitled "Need for Independence in Compilation Engagements" to obtain input on whether independence should be required when performing a compilation engagement.

ment, and, if so, how impairment of the practitioner's independence should best be communicated in the accountant's compilation report. After considering the comments received, the ARSC plans to address this issue at a public meeting.

The survey is available by clicking on the blue rectangle at <http://www.aicpa.org/members/div/auditstd/index.htm>. The ARSC welcomes responses to the survey from all interested parties. The survey may be submitted directly through the electronic survey or via electronic mail to Michael Glynn at [mglynn@aicpa.org](mailto:mglynn@aicpa.org) no later than May 19, 2006.

The ARSC also requests that practitioners alert their colleagues and clients to the survey and the input the ARSC is seeking, and that practitioners ask their clients to inform known third-party users of compiled financial statements about the survey.

## **ASB Votes to Issue ED Revising AT 501, *Reporting on Internal Control Over Financial Reporting***

*by Judith M. Sherinsky*

At its October 2005 meeting, the Auditing Standards Board (ASB) voted to issue an exposure draft of a revision of Chapter 5, "Reporting on an Entity's internal Control Over Financial Reporting," of Statement on Standards for Attestation Engagements (SSAE) No. 10, *Attestation Standards: Revision and Recodification* (AT 501). The proposed SSAE is being issued to enhance the practitioner's ability to identify and evaluate control deficiencies and to report on internal control.

An earlier exposure draft of AT 501 was issued in March 2003; however, after amending the exposure draft for certain matters noted in comment letters, the ASB, at its September 28-30, 2004 meeting, decided that the draft should be revised to incorporate certain terminology and related guidance in Public Company Accounting Oversight Board Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*. The ASB also recommended that AT 501 be tailored to the needs of nonissuers and regulated entities, such as financial institutions, insurance companies, and governmental entities who might use AT 501 to report on internal control. At its December 14, 2004, meeting, the ASB recommended that AT 501 be revised and reexposed for comment because of the significant changes that would be made to the document.

The proposed standard revises the requirements and guidance for a practitioner reporting on the internal control of an entity that is a *nonissuer*. The Sarbanes-Oxley Act of 2002 created the Public Company Accounting Oversight Board (PCAOB) and charged it with overseeing audits of *issuers* (entities subject to the Act or the rules of the Securities and Exchange Commission). On March 9, 2004, the PCAOB issued Auditing Standard No. 2, which establishes the standards for an audit of the internal control of an issuer performed in conjunction with the audit of the issuer's financial statements. The ASB's exposure draft reflects much of what is included in Auditing Standards No. 2.

The proposed SSAE:

- Provides guidance to a practitioner on evaluating management's basis or substantiation for making an assertion about an entity's internal control over financial reporting.
- Recognizes that for nonissuers, the party responsible for an entity's internal control may take many different forms, for example, a board of directors, a committee of management, or an owner in an owner-managed entity.



- Uses the term *those charged with governance* to refer to the party responsible for overseeing the strategic direction of an entity and the entity's financial reporting and disclosure process (the party responsible for an entity's internal control).
- Incorporates the definitions of the terms *control deficiency* and *material weakness* used in PCAOB Auditing Standard No. 2, and replaces the term *reportable condition* with the term *significant deficiency* and its related definition in PCAOB Auditing Standard No. 2.
- Provides guidance to the practitioner on evaluating:
  - Deviations in the design or operation of controls and whether they constitute control deficiencies.
  - The severity of control deficiencies, based on their nature, likelihood, and magnitude, including whether misstatements or potential misstatements are "more than inconsequential."
- Identifies specified control deficiencies that ordinarily would be considered at least significant deficiencies.
- Identifies specified circumstances that should be regarded as at least a significant deficiency and a strong indicator of a material weakness.
- Requires an entity's financial statements to be audited for a practitioner to examine that entity's internal control.
- Requires the practitioner examining an entity's internal control to communicate with the auditor of the entity's financial statements if the examination of internal control and the audit of the financial statements are performed by different CPAs.
- Requires the practitioner, after concluding whether a control deficiency is a significant deficiency or a material weakness, to consider whether "people with general business knowledge and experience" would agree with the practitioner's conclusion.
- Contains examples that depict how a practitioner might consider and evaluate the significance of an account and respond to that evaluation.
- Requires the practitioner to communicate, in writing, to management and those charged with governance any significant deficiencies and material weaknesses that exist as of the date of management's assertion, those the practitioner becomes aware of during the examination, and any known or suspected fraud.
- Contains reporting guidance for engagements in which the scope of the internal control has been expanded, for example, examinations of the internal control of insured depository institutions subject to the internal control reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA).
- Includes new appendices that:
  - Present examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses

- Provide an illustrative report that management must provide to external parties if the practitioner's report is to be for general use.
- Provide an illustrative written communication from the practitioner to those charged with governance of any significant deficiencies and material weaknesses that exist as of the date of management's assertion, those the practitioner becomes aware of during the examination, and any known or suspected fraud.

Also, accompanying the exposure draft is a document entitled "A Framework for Assessing Control Exceptions and Deficiencies," designed to assist practitioners in applying the proposed SSAE by presenting a method for evaluating the significance of exceptions and control deficiencies. The document is not part of the proposed SSAE; however, the ASB is seeking input from readers regarding whether the document is helpful in applying the SSAE, and whether it should be included as a permanent appendix to the SSAE.

## Highlights of Technical Activities

The Auditing Standards Board (ASB) performs its work through task forces composed of members of the ASB and others with technical expertise in the subject matter of the projects. The findings of these task forces periodically are presented to the members of the ASB at public meetings for their review and discussion. Highlights of matters addressed by the ASB are available at:

<http://www.aicpa.org/members/div/auditstd/calendar/asbmtghlts.htm>.

## Task Forces of the ASB

Following are the current task forces of the ASB and brief summaries of their objectives and recent activities.

**Amendments to SAS No. 69** (Staff Liaison: Dionne McNamee). At its July 2005 meeting, the ASB voted to issue a Statement on Auditing Standards (SAS) that amends SAS No. 69, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles" (AU sec. 411), subject to deliberations by the Financial Accounting Standards Board (FASB) on its related project. The May 9, 2005 exposure draft was issued in response to the "GAAP Hierarchy" project conducted by the FASB. On April 28, 2005 the FASB issued an exposure draft of a proposed Statement of Financial Accounting Standards (SFAS) entitled "The Hierarchy of Generally Accepted Accounting Principles." Until now, the GAAP hierarchy, for all entities, has resided in the auditing literature in SAS No. 69. The FASB exposure draft transfers the GAAP hierarchy for nongovernmental entities from the auditing literature to the accounting literature and clarifies that the FASB is responsible for identifying the sources of accounting principles and the framework for selecting such principles used in the preparation of nongovernmental entity financial statements presented in conformity with GAAP. The FASB discussed comments received on its exposure draft at its August 24, 2005 meeting. The FASB decided to add transition provisions and approved the standard for final issuance. The FASB instructed its staff to coordinate effective dates with the staffs of the ASB and the Public Company Accounting Oversight Board (PCAOB). Once the new SAS becomes effective, SAS No. 69 would contain the GAAP hierarchy for state, local, and federal government entities and would refer readers to the FASB SFAS for the GAAP hierarchy for nongovernmental entities. Although the FASB may change this hierarchy in the future, the FASB exposure draft essentially carries forward the existing hierarchy with certain modifications, such as inclusion of FASB Staff Positions and FASB Statement No. 133 Implementation Issues as a source of category (a) accounting principles. The ASB intends to issue a final SAS at the same time the FASB and PCAOB issue their final standards. The PCAOB expects to issue its final standard in early 2006.

**Auditing Accounting Estimates** (Staff Liaison: Hiram Hasty; Task Force Chair: Harold Monk Jr.). The task force plans to revise SAS No. 57, *Auditing Accounting Estimates* (AU sec. 342), in light of the revised exposure draft, International Standard on Auditing (ISA) 540, *Auditing Accounting Estimates and Related Disclosures (Other than Those Involving Fair Value Measurements and Disclosures)*, issued by the International Auditing and Assurance Standards Board (IAASB) in December 2004. In developing an exposure draft, the task force will monitor the progress of ISA 540 and consider the IAASB's deliberations and drafts.

**Auditing Related Party Transactions Task Force** (Staff Liaison: Michael P. Glynn; Task Force Chair: George P. Fritz). The task force plans to revise SAS No. 45, *Related Parties* (AU sec. 334), to achieve convergence with the related ISA that the IAASB is developing. The task force will closely monitor the IAASB's progress on this issue.

**Audit Issues Task Force** (Staff Liaison: Sharon Walker; Task Force Chair: John A. Fogarty). This task force (1) oversees the ASB's planning process, (2) evaluates technical issues raised by various constituencies and determines their appropriate disposition, including referral to an ASB task force or development of an interpretation or other guidance, (3) addresses emerging audit and attestation practice issues, (4) provides advice on ASB task force objectives and composition, and monitors the progress of task forces, and (5) assists the chair of the ASB and the Audit and Attest Standards staff in carrying out their functions, including liaising with other groups. The AITF will hold its next meeting on December 1, 2005 in Washington, DC.

**Auditors' Reports Task Force** (Staff Liaison: Sharon Walker; Task Force Chair: Harold L. Monk). This task force is revising SAS No 58, *Reports on Audited Financial Statements* (AU sec. 508), in light of the IAASB's recently exposed ISA, *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*, and PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the PCAOB*. The ASB believes that it is appropriate and timely to revisit the required reporting elements and the language in the auditor's report for audits of nonissuers. The ASB further believes that clarifying certain aspects of the report will help to narrow the expectation gap. The task force will present a draft of a proposed statement on auditing standards for discussion at the January 2006 ASB meeting.

**Communications Task Force** (Staff Liaison: Ahava Goldman; Task Force Chair: Daniel D. Montgomery). The task force is revising SAS No. 61, *Communication with Audit Committees* (AU sec. 380), to incorporate elements of proposed ISA 260, *The Auditor's Communication with Those Charged with Governance*, issued by the IAASB. The task force will present a draft of a proposed statement on auditing standards for discussion at the January 2006 ASB meeting.

**Group Audits Task Force** (Staff Liaison: Ahava Goldman; Task Force Chair: Diane M. Rubin). The task force is considering revisions to AU Section 543, *Part of Audit Performed by Other Independent Auditors*, in light of the exposure draft of proposed ISA 600, *The Audit of Group Financial Statements*, issued by the IAASB on March 22, 2005. The task force will closely monitor the IAASB's progress on this issue.

**Internal Control Task Force** (Staff Liaison: Judith M. Sherinsky; Task Force Chair: Michael T. Umscheid). On September 1, 2005, the ASB issued an exposure draft of a proposed SAS that would supersede SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AU sec. 325). The exposure period ended on October 31 and the task force will meet on December 13, 2005 to consider the comments letters received. The exposure draft can be viewed at: [http://www.aicpa.org/download/auditstd/2004\\_0928ASBHiglts.pdf](http://www.aicpa.org/download/auditstd/2004_0928ASBHiglts.pdf). The task force expects the ASB to vote to issue the document as a final SAS at its January 2006 meeting.

The task force also is revising, Chapter 5, *Reporting on an Entity's Internal Control Over Financial Reporting*, of Statement on Standards for Attestation Engagements (SSAE) No. 10 (AT 501) to reflect elements of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*, that are relevant to nonissuers. At its October 2005 meeting, the

ASB presented a draft of that revision which the ASB voted to issue as an exposure draft. See the article on page 7, “ASB Votes to Issue ED Revising AT 501, *Reporting on an Entity’s Internal Control Over Financial Reporting*,” for information about the exposure draft.

**International Auditing Standards Subcommittee** (Staff Liaison: Sharon Walker; Subcommittee Chair: Susan S. Jones). The objective of this subcommittee is to support the development of international auditing standards. Subcommittee activities include providing technical advice and support to the AICPA representative and technical advisors to the IAASB, commenting on exposure drafts of international assurance standards, participating in and identifying U.S. volunteer participants for international standard-setting projects, identifying opportunities for establishing joint standards with other standard setters, identifying international issues that affect auditing and attestation standards and practices, and assisting the ASB and other AICPA committees in developing and implementing AICPA international strategies.

**Investment Performance Statistics Task Force** (Staff Liaison: Ahava Goldman; Task Force Chair: Peter McNamara). The task force is revising Statement of Position (SOP) 01-4, *Reporting Pursuant to the Association for Investment Management and Research Performance Presentation Standards* (AIMR PPS), in light of the recent convergence of the AIMR-PPS with the Global Investment Performance Standards, which are issued by the CFA Institute, an international nonprofit organization of investment practitioners and educators.

**Management Representations Task Force** (Staff Liaison: Ahava Goldman; Task Force Chair: Keith O. Newton). The task force is considering revisions to SAS No. 85, *Management Representations* (AU sec. 333) in light of the IAASB’s project to revise ISA 580, *Management Representations*. The task force will closely monitor the IAASB’s progress on this issue.

**Quality Control Standards Task Force** (Staff Liaison: Ahava Goldman; Task Force Chair: **David Brumbeloe**). The task force is considering revisions to Statements on Quality Control Standards related to the IAASB’s International Standard on Quality Control No. 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Service Engagements*.

**Using the Work of a Specialist Task Force** (Staff Liaison: Hiram Hasty; Task Force Chair: Michael T. Umscheid). The objective of the task force is to revise SAS No. 73, *Using the Work of a Specialist*, and replace it with two new standards. One of the proposed standards, *Using an Outside Specialist to Assist in the Audit*, addresses situations in which an auditor engages an outside (non-firm) specialist to obtain specialized skills or knowledge needed in the audit, but not available on the engagement team. The other proposed standard, *Using the Work of Management’s Nonemployee Specialist*, focuses on situations in which an auditor uses as audit evidence the work product of a nonemployee specialist hired by management.

At its December 6-10, 2004 meeting, the IAASB added to its agenda a project to revise ISA 620, *Using the Work of an Expert*. At its February 1-3, 2005 meeting, the ASB approved the submission of a recommendation to the IAASB consisting of the two proposed SASs developed by the task force. The task force will monitor the progress of the IAASB’s standard and consider the IAASB’s deliberations and drafts in developing its exposure draft.

## Other Activities

**Accounting and Review Services Committee (ARSC)** (Staff Liaison: Michael Glynn; Committee Chair: Thomas A. Ratcliffe). The ARSC is the senior technical committee of the AICPA designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of nonpublic entities. The charge of the ARSC is to develop and communicate, on a continuing basis, comprehensive performance and reporting standards as well as practice guidance that enable practitioners to provide high quality, objective, compilation and review services that serve the profession, clients, and the general public.

The ARSC accomplishes this objective by developing compilation and review standards, timely responding to the need for guidance, and clearly communicating such guidance to the profession and users of financial statements. The ARSC recently issued a survey entitled "Need for Independence in Compilation Engagements." For additional information about the survey, please see the article on page 6, "ARSC Conducts Survey on Independence in Compilation Engagements". The ARSC will hold its next meeting on November 29-30 at the New York office of the AICPA. The subsequent meeting will be held in the late second quarter of 2006 at the New Jersey office of the AICPA. When the meeting date is finalized, it will be posted in the *CPA Letter*. To view highlights of past and current ARSC meetings, please see the following AICPA web site: <http://www.aicpa.org/members/div/auditstd/calendar/arscmtghlts.htm>.

**Anti-Fraud Task Force** (Staff Liaison: Michael P. Glynn; Task Force Chair: Ronald L. Durkin). The Anti-Fraud Task Force is charged with further developing the specificity of criteria for management anti-fraud programs and controls, as introduced in the document, *Management Antifraud Programs and Controls: Guidance to Help Prevent, Deter, and Detect Fraud*, issued jointly by several organizations, including the AICPA. The task force is currently considering its next project.

**Auditing Standards Committee of the American Accounting Association (AAA)** (Chair: Bob Allen, University of Utah; ASB/AICPA Liaisons to the Committee: Douglas Prawitt and Michael P. Glynn). The Auditing Standards Committee of the AAA is charged with fostering interaction between the AAA's Auditing Section and auditing standard-setting bodies such as the AICPA's ASB. The ASB supports strengthening its relationship with the academic community as well as increasing the community's participation in the standard-setting process.

**International Auditing and Assurance Standards Board (IAASB)** (U.S. Member: John A. Fogarty; U.S. Technical Advisor: Charles E. Landes). The IAASB met in September and October 2005 in New York. At its September 2005 meeting, the IAASB approved for final issuance ISA 230 (Revised), *Audit Documentation*.

In October 2005, the IAASB issued exposure drafts of four auditing standards in a new drafting style, an exposure draft titled *Proposed Amendments to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services*, and an Explanatory Memorandum to accompany the exposure drafts. The IAASB developed its new drafting style based on responses to its 2004 "Proposed Policy Statement and Consultation Paper on Clarity." Key elements of the new drafting style include:


- Basing the standards on objectives, as opposed to procedural considerations
- Use of the word "shall" to identify requirements that the professional accountant is expected to follow in the vast majority of engagements
- Eliminating the present tense to describe actions by the professional accountant, which some had regarded as ambiguous in terms of obligation, and
- Structural improvements to enhance the overall readability and understandability of the standards.

The due date for comments on these exposure drafts is February 28, 2006.

Copies of the International Federation of Accountants' (IFAC) final auditing, assurance, related services, and quality control standards; exposure drafts outstanding, and information about attending IAASB meetings, which are open to the public, can be found at: <http://www.ifac.org/> The next meeting of the IAASB will be held December 5-9, 2005 in Cape Town, South Africa.

**Professional Issues Task Force (PITF)** (Staff Liaison: Michael P. Glynn; Task Force Chair: Charles J. McElroy). The PITF is responsible for accumulating and considering practice issues that appear to present





concerns for practitioners performing audits and reviews of financial statements or agreed-upon procedures. The PITF also is responsible for disseminating information or guidance, as appropriate, in the form of practice alerts. Practice alerts are intended to provide practitioners with information that may help them improve the effectiveness and efficiency of their engagements and practices, and are based on existing professional literature, the experience of the members of the PITF, and information provided by AICPA member firms to their own professional staffs. The task force also refers matters that may require reconsideration of existing standards to the appropriate standard-setting body. All alerts that have not been superseded are available at [http://www.aicpa.org/members/div/auditstd/pract\\_alerts.asp](http://www.aicpa.org/members/div/auditstd/pract_alerts.asp). In addition, the alerts are published annually in the AICPA Technical Practice Aids. The PITF recently issued Practice Alert 2005-1 “Auditing Procedures With Respect to Variable Interest Entities”. For additional information about the Practice Alert, please see the article on page 4, “Practice Alert Addresses Variable Interest Entities.”



## Auditing Standards Board Agenda

Codes: DI—Discussion of issues, DD—Discussion of draft document, ED—Vote to ballot a document for exposure, EP—Exposure Period, CL—Discussion of comment letters, FI—Vote to ballot a document for final issuance, SU—Status Update.

Project	<u>ASB Meeting Date</u> January 10-12, 2006 San Diego, CA
Auditor's Reports	DD
Communication of Internal Control Related Matters	FI
Communication With Audit Committees	ED
Investment Performance Statistics (AIMR-PPS)	DD
Quality Control	DI
Related Parties	DI

To view a projected timetable of ASB projects through 2007, see the following AICPA web site:  
[http://www.aicpa.org/members/div/auditstd/asb\\_project\\_timetable.htm](http://www.aicpa.org/members/div/auditstd/asb_project_timetable.htm)

## Recently Issued and Approved Documents

Statements on Auditing Standards (SASs) and Statements on Standards for Attestation Engagements (SSAEs)		
Title (Product Number)	Issue Date	Effective Date
SAS No. 103, <i>Audit Documentation</i> (060706)	December 2005	Effective for audits of financial statements for periods ending on or after December 15, 2006.
SAS No. 102, <i>Defining Professional Requirements in Statements on Auditing Standards</i> (060705)	December 2005	Effective upon issuance.
Statement on Standards for Attestation Engagements (SSAE) No. 13, <i>Defining Professional Requirements in Statements on Standards for Attestation Engagements</i> (023032)	December 2005	Effective upon issuance.

## Interpretations of Statements on Auditing Standards (SASs)

Title	Issuance Date <sup>1</sup>
<p>Interpretation of SAS No. 101, <i>Auditing Fair Value Measurements and Disclosures</i></p> <p>Interpretation No. 1, "Auditing Investments in Securities Where a Readily Determinable Fair Value Does Not Exist" (AU sec. 9101.01-04)</p>	August 2005
<p>Interpretation of SAS No. 92, <i>Auditing Derivative Instruments, Hedging Activities, and Investments in Securities</i></p> <p>Interpretation No. 1, "Auditing Interests in Trusts Held by a Third-Party Trustee and Reported at Fair Value" (AU sec. 9332. 01-.04)</p>	August 2005
<p>Interpretation of SAS No. 50, <i>Reports on the Application of Accounting Principles</i></p> <p>Interpretation No. 1, "Requirement to Consult With the Continuing Accountant" (AU sec.9625. 01-09)</p>	January 2005
<p>Interpretation of SAS No. 62, <i>Special Reports</i></p> <p>Interpretation No. 12, "Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis" (AU sec. 9623.60-.77)</p> <p>Interpretation No. 14, "Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity with an Other Comprehensive Basis of Accounting (OCBOA)" (AU sec. 9623.90-.95)</p> <p>Interpretation No. 15, "Auditor Reports on Regulatory Accounting or Presentation When the Regulated Entity Distributes the Financial Statements to Parties Other Than the Regulatory Agency Either Voluntarily or Upon Specific Request." (AU sec. 9623.96-.98)</p>	<p>Amended January 2005</p> <p>Amended January 2005</p> <p>Amended January 2005</p>

<sup>1</sup> The issuance date of interpretations of Statements on Auditing Standards and interpretations of Statements on Standards for Accounting and Review Services is the first date the document is made widely available to the public. In most cases, this will be the date the document is posted to the AICPA Web site: [www.aicpa.org](http://www.aicpa.org). There may be cases in which the document is first made widely available in hard copy, or published in the *Journal of Accountancy*. In those cases, the publication date of the document is considered to be the date of publication of the hard copy, or the date of publication in the *Journal of Accountancy*.

Statements on Standards for Accounting and Review Services (SSARs)		
Title (Product Number)	Issue Date	Effective Date
SSARS No. 14, <i>Compilation of Pro Forma Financial Information</i> (060652)	July 2005	Effective for engagements entered into after December 15, 2005. Early application is permitted.
SSARS No. 13, <i>Compilation of Specified Elements, Accounts, or Items of a Financial Statement</i> (060651)	July 2005	Effective for engagements entered into after December 15, 2005. Early application is permitted.
SSARS No. 12, <i>Omnibus Statement on Standards for Accounting and Review Services - 2005</i> (060650)	July 2005	<p>The Statement consists of three amendments to AR section 100 and one amendment to AR section 200.</p> <p>The following amendments are effective for engagements for periods ending after December 15, 2005. Early Application is permitted:</p> <ul style="list-style-type: none"> <li>• The Accountant's Consideration of Fraud and Illegal Acts in a Compilation or Review Engagement</li> <li>• The Accountant's Consideration of Obtaining an Updating Representation Letter From Management</li> <li>• Restated Prior-Period Financial Statements</li> </ul> <p>The following amendment is effective upon issuance:</p> <p>Restricting the Use of an Accountant's Compilation or Review Report</p>

Interpretations of Statements on Standards for Accounting and Review Services (SSARs)	
Title	Issuance Date <sup>1</sup>
Interpretation of SSARS No. 1, <i>Compilation and Review of Financial Statements</i>	August 2005
Interpretation No. 27, "Applicability of SSARs to Reviews of Nonissuers Who Are Owned By or Controlled By an Issuer" (AR sec. 9100.104 -.108)	

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## AICPA Audit and Attest Standards Staff

Name	Title	E-mail address
Charles E. Landes	Vice President	clandes@aicpa.org
Michael P. Glynn	Technical Manager	mglynn@aicpa.org
Ahava Goldman	Technical Manager	agoldman@aicpa.org
Hiram Hasty	Technical Manager	hhasty@aicpa.org
Dionne McNamee	Technical Manager	dmcnamee@aicpa.org
Judith M. Sherinsky	Technical Manager	jsherinsky@aicpa.org
Sharon Walker	Technical Manager	swalker@aicpa.org
Sherry P. Hazel	Administrative Secretary	shazel@aicpa.org
Sharon Macey	Administrative Secretary	smacey@aicpa.org

**For additional information about projects of the Audit and Attest Standards Staff and the Auditing Standards Board, call (212) 596-6036.**

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**Editor: Judith M. Sherinsky**

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